THE SUPREME COURT AND MUNICIPAL BONDS.– ANOTHER STEP.

IN the HARVARD LAW REVIEW for November, 1891, we ventured to question the soundness of the reasoning approved by the Supreme Court of the United States in an opinion delivered by Mr. Justice Lamar in Merrill *v.* Monticello.[1] That opinion, we there said, virtually asserted the doctrine that although there be conferred upon a municipal corportion a power to borrow money, such corporation has no power to raise the money by selling its bonds; or, to express the proposition in another form, that a power in the charter to borrow money does not include the power to give a negotiable bond therefor.

The conclusion reached in that case evinced a wide departure from what had been regarded for many years as the settled rule. A great many savings institutions, insurance companies, trustees, and private persons seeking safe investment, had accustomed themselves to treat, as a firm foundation for them action, a rule so obviously just in its inception, and so long upheld by the Supreme Court. In examining municipal securities offered to them with a view to purchase, these investors, fully confident that the doctrine so long established would never be departed from, confined their inquiries to other points of scrutiny than that of the power to issue. Where a charter empowered a municipality to borrow, the careful trustee looked to see for what *purpose* the money was to be borrowed, not dreaming that it would be objected at some future day that the bond was worthless, unless special legislative authority could be shown for its issue. The line of reasoning adopted in *Merrill* v. *Monticello* must have struck the public who are interested in the subject as remarkable for the consequences that would logically follow.

We need hardly say that, reluctant as we were to enter upon such criticism, we felt amply justified in calling the attention of the profession to the views sanctioned by the court in that opinion. We tried to subject Mr. Justice Lamar's observations to the test

[1] 138 U. S. 673.

of as searching an analysis as it was in our power to give to them, hoping that we might uncover the precise reasons for advancing what to us appeared to be a new and mischievous doctrine. With all proper respect for so able a Bench, we were unable to satisfy ourselves that the steps taken to reach the result in that decision were correct. On the contrary, the reasoning appeared to be fallacious and unsound.

The doctrine there advanced is plainly at variance with that of Rogers *v.* Burlington (1865),[1] and Mitchell *v.* Burlington (1866).[2] But the opinion of Mr. Justice Lamar did not in terms overrule these early decisions. It has been left to the court at the present term to take this step, and to announce that the later cases in this court are to be regarded as overruling the two decisions mentioned. This announcement, it is apparent, must be understood as the judicial interpretation of what Merrill *v.* Monticello really means. The announcement is made in The City of Brenham *v.* The German-American Bank, decided March 28, 1892, Mr. Justice Blatchford delivering the opinion of the court, Justices Harlan, Brewer, and Brown dissenting.[3]

Because the stand now taken by the court reverses the settled doctrine of years, and threatens to lead to consequences that are far-reaching and greatly to be deplored, — in plain words, because of the mischief that these views are likely to work if they shall be adhered to, — we think that we are warranted in returning to the subject for the purpose of submitting one or two further considerations that bear upon the fallacy of the underlying proposition upon which this novel doctrine is sought to be based.

We may, therefore, state briefly the material facts of the Brenham case, and quote the language of the learned justice, in which he declares that the city had no power to issue the bonds in question.

The city of Brenham, Texas, plaintiffs, by writ of error to the Circuit Court of the United States for the Western District of Texas, sought to reverse a judgment against it for $5,510 upon its coupons. The bonds were of an issue of $15,000 in the usual form, bearing interest at ten per cent, and dated July 31, 1879.

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[1] 3 Wall. 654.

[2] 4 Wall. 270.

[3] The case was argued while the late Mr. Justice Bradley was on the bench. Upon his death, the court, consisting of eight justices, ordered a re-argument. The decision, therefore, is that of five justices to three.

On their face they bore the title, "Bonds for General Purposes," and referred to an ordinance of the city authorizing their issue.

The Legislature of Texas, it seems, passed an Act, Feb. 4, 1873, incorporating the city of Brenham. Its population was over four thousand and less than ten thousand inhabitants. The charter, among other things, provided "That the city council shall have the power and authority to borrow for general purposes not exceeding ($15,000) fifteen thousand dollars on the credit of said city." Another article of the Act of Incorporation reads: "Bonds of the corporation of the city of Brenham shall not be subject to tax under this Act."

The city council, June 7, 1879, by ordinance voted to issue $15,000 ten per cent coupon bonds, to be sold by the mayor and finance committee as the same might be required for general purposes, but at no greater discount than five per cent. The bonds were issued under date of July 31, 1879. Three thousand dollars were used for the fire department. The remaining twelve thousand (of which the German-American Bank, of New York city, became eventually the owners) were devoted to the purchase of depot grounds, and of the right of way of a railroad through the city.

At the argument, certain sections of one of the articles of the constitution of Texas of 1876, respecting the right of cities to lay, assess, and collect taxes, were alluded to; but they are not material to the present discussion, seeing that the court has put its decision upon the ground of a want of power in the charter to issue a negotiable bond, irrespective of any consideration of the effect of the constitution.

The court below (Boarman, J.) charged the jury (35 Federal Reporter, 185) that the power in the city to borrow money carried with it the authority to issue the bonds. "It may be that the limitation of the power to tax beyond one quarter of one per cent impairs the ability of the defendant to pay the bonds and coupons; but I do not think it denies the capacity of the corporation in 1879 to issue the bonds as commercial paper and bind the constituency to the payment thereof." To this instruction the defendant excepted, on the grounds, *first*, "that under the constitution of Texas the expense of carrying out the general governmental purposes of the defendant is to be defrayed by the levy of a tax, and not by the issuance of bonds; and, *second*, that the bonds are not clothed with the incidents of commercial paper."

The point as to the want of authority to issue the bonds was also

raised by demurrer. The demurrer was overruled, and the defendants saved their exception.

Mr. Justice Blatchford says: "The principal contention on the part of the defendant is, that it was without authority to issue the bonds, and that they were void for all purposes and in the hands of all persons. This point is presented with reference to the charter of 1873, considered apart from the provisions of the constitution of 1876, and also with reference to the effect which the constitution had upon the power claimed under the charter."

In order justly to estimate the force of the reasoning adopted by the court, it becomes needful to quote freely from Mr. Justice Blatchford's opinion. After citing from the article of the constitution conceived to be applicable, the justice proceeds as follows:

"There is nothing in the charter of the defendants which gives it any power to issue negotiable interest-bearing bonds of the character of those involved in the present case. The only authority in the charter that is relied upon is the power given to borrow, for general purposes, not exceeding $15,000, on the credit of the city. The power given to the defendant by Section 4 of Article XI. of the Constitution — the defendant having a population of less than ten thousand inhabitants at the date of its charter and at the date of the ordinance — was only the power to levy, assess, and collect an annual tax to defray the current expenses of its local government, not exceeding for any one year one fourth of one per cent.

"That in exercising its power to borrow not exceeding $15,000 on its credit, for general purposes, the city could give to the lender, as a voucher for the repayment of the money, evidence of indebtedness in the shape of non-negotiable paper, is quite clear; but that does not cover the right to issue negotiable paper or bonds unimpeachable in the hands of a *bona-fide* holder. In the present case, it appears that Mensing bought from the defendant $5000 of the bonds at ninety-five cents on the dollar, and that other $7000 of the bonds were sold by the city for the same price, it thus receiving only $11,400 for $12,000 of the bonds, and suffering a discount on them of $600. The city thus agreed to pay $12,000, and interest thereon, for $11,400 borrowed. This shows the evil working of the issue of bonds for more than the amount of money borrowed. . . .

"The power to borrow the $11,400 would not have been nugatory, unaccompanied by the power to issue negotiable bonds therefor.[1]

"The confining of the power in the present case to a borrowing of

[1]Merrill *v.* Monticello, 138 U. S. 673; Williams *v* Davidson, 43 Tex. 1; City of Cleburne *v.* Railroad Co., 66 Tex. 461; 1 Dillon on Municipal Corp., 4th ed., § 89 *and notes*, § 91, *n.* 2; § 126, *n.* 1; §§ 507, 507 *a*.

money for general purposes on the credit of the city, limits it to the power to borrow money for ordinary governmental purposes, such as are generally carried out with revenues derived from taxation; and the presumption is that the grant of the power was intended to confer the right to borrow money in anticipation of the receipt of revenue taxes, and not to plunge the municipal corporation into a debt on which interest must be paid at the rate of ten per centum per annum, semi-annually, for at least ten years. It is easy for the Legislature to confer upon a municipality, when it is constitutional to do so, the power to issue negotiable bonds; and under the well-settled rule that any doubt as to the existence of such power ought to be determined against its existence, it ought not to be held to exist in the present case."

The opinion then proceeds to review a number of cases, ending with Merrill *v.* Monticello, from which the justice quotes at considerable length, and closes by saying: "As there was no authority to issue the bonds, even a *bona fide* holder of them cannot have a right to recover upon them or their coupons."

What is likely first to attract the reader's attention is the fact that the opinion rests the decision of the case squarely upon the ground that the power given the city by charter to borrow money for general purposes does not authorize the city to issue negotiable bonds. We wish in this article to be understood as not passing upon the question of the validity of the bonds generally; we are concerned only with the doctrine of the meaning of a power granted a municipal corporation to "borrow money."

The highly important inquiry as to the legitimacy of the purpose for which the bonds were to be used, appears to have been considered here as of little moment. True, the court says that the power of the city to borrow is limited to borrowing "money for ordinary governmental purposes, such as are generally carried out with revenues derived from taxation." But the court does not go on to determine whether the purposes disclosed were within the scope of such general purposes as the city was empowered to borrow money for. To purchase hose and pay for a steam fire-engine, might seem appropriate purposes; but to buy depot grounds, and the right of way for a railroad, are purposes that perhaps would admit, to say the least, of some doubt. The fact that the opinion attaches no significance whatever to the object for which the bonds were actually used, but directs its entire reasoning to the question of the true meaning of the power to borrow money, commits the court all the more strongly to the proposition which,

as has already been indicated, we cannot but regard as wholly unsound.

The example given by Mr. Justice Blatchford of the "evil working of the issue of bonds for more than the amount of the money borrowed," and the mention of a presumption that the grant of power in the charter was not intended to "plunge the municipal corporation into a debt on which interest must be paid at the rate of ten per centum per annum semi-annually for at least ten years," are well designed to satisfy the reader that the city of Brenham, Texas, in 1879, could not borrow at a rate quite so favorable as the city of Boston, Massachusetts. The court are careful, however, not to decide that the purpose was *ultra vires*.

In this connection it may be remarked that there is much good sense in what Mr. Justice Grier says, in one of the earliest of the these bond decisions:—

> "Although we doubt not the facts stated as to the atrocious frauds which have been practised in some counties in issuing and obtaining these bonds, we cannot agree to overrule our own decisions and change the law to suit hard cases. The epidemic insanity of the people, the folly of county officers, the knavery of railroad 'speculators,' are pleas that might have just weight in an application to retain the issue or negotiation of these bonds, but cannot prevail to authorize their repudiation after they have been negotiated and have come into the possession of *bona-fide* holders."[1]

Let us endeavor to ascertain, then, by just what process of reasoning it is that the learned justice arrives at the conclusion that the city of Brenham had no power under its charter to issue a negotiable bond.

The prevailing thought in the judicial mind appears to be that to borrow money is one thing,—to give a negotiable bond as a means of borrowing money is another and a distinct thing. The power to give certificate of indebtedness or a voucher does not, says the opinion, "cover the right to issue negotiable paper or bonds unimpeachable in the hands of a *bona-fide* holder."

Certainly not. They are two different rights. But both of them are methods of borrowing money. It is not apprehended that the bank in this case claimed that the city's right to issue the bonds was "covered" by its undisputed right to give to its creditor an ordinary certificate of indebtedness. Mr. Justice

[1] Mercer County *v.* Hackett (1863), 1 Wall. 96.

Blatchford quotes with approval the following language of Mr. Justice Lamar in Merrill *v.* Monticello: "To borrow money and to give a bond or obligation therefor which may circulate in the market as a negotiable security freed from any equities that may be set up by the maker of it, are in their nature and in their legal effect essentially different transactions."

Now we undertake to say that confusion of thought is betrayed in the proposition just stated. It is not true in the sense in which it is here used. To borrow the money for which the bond is given (and that is the only money that figures in the business), and to give the bond, is but one transaction. When a bank customer borrows a hundred dollars from the bank, and gives his promissory note therefor, there are not two transactions. Borrowing money from a bank *means* giving a note.

To give an evidence of indebtedness as a voucher, to pass a promissory note, to hand over a negotiable bond, — what are these acts but so many modes of executing the same power; namely, a power to borrow money? It is usual and customary — nay, it is universal — when sums of money of any considerable amount are borrowed, for the debtor to give his negotiable note or bond for its payment. The creditor does not lend except he receives at the same time, and as a part of the transaction, this kind of a security. A power to borrow implies, *ex vi termini*, the right to issue negotiable paper to secure payment of the sum borrowed.

Article I., Section 8, of the Constitution of the United States empowers Congress to "borrow money on the credit of the United States." Has any one been heard to question the authority of Congress, under this clause, to provide for the issuing of negotiable bonds of the United States? If it be asked why not, the reply is obvious: Because Congress, being empowered to borrow money, has the exclusive right to determine upon the time when the necessity shall have arisen for resorting to its exercise, as well as the means by which the money can most conveniently be obtained. To put down the rebellion, the government "borrowed money" of its citizens and of Europe. Borrowing the money and issuing the bonds were not two entirely distinct transactions.

The powers of a municipal corporation are limited, of course, by its charter. Every one admits that it is wise and prudent to restrict such bodies within certain well-defined bounds. This useful end may be attained, however, by applying circumspection to the *purposes* for which the corporate body is allowed to exercise its chartered powers.

Has a city the right to borrow money for general purposes? A strict rule may with great propriety narrow the limits within which the term "general purposes" shall be applied. Such, indeed, is the field for the legitimate exercise of this safe principle of construction; but it is error to maintain that such a principle has application to the mode of effectuating a power to borrow.

Mr. Justice Blatchford reviews the prior decisions of the Supreme Court; but it is unnecessary to follow him here, because his steps are simply a repetition of those taken by Mr. Justice Lamar in the Monticello case. And it is upon the Monticello decision that the present opinion practically rests; so that it may be said that the reasoning offered to us is that upon which comment has already been made in our November article. It substantially amounts to this, that a municipal corporation has limited powers only; it can do only certain things; or, as Mr. Justice Field well phrases it, —

"Municipal corporations are established for purposes of local government, and in the absence of specific delegation of power cannot engage in any undertakings not directed immediately to the accomplishment of these purposes. Private corporations created for private purposes may contract debts in connection with their business, and issue evidences of them in such form as may best suit their convenience. The inability of municipal corporations to issue negotiable paper for their indebtedness, however incurred, unless authority for that purpose is expressly given of necessarily implied for the execution of other express powers, has been affirmed in repeated decisions of this court."[1]

To issue negotiable bonds we are told is to "plunge the municipal corporation into debt," which leads to abuses; and the Legislature may, if it see fit, grant the right, but city councils ought not to have it unless given in special terms. Hence, inasmuch as it is one thing to borrow money and an essentially different thing to give a negotiable bond therefor, it follows that when the Legislature empowers a city to borrow money, it means that the city may give a certificate of indebtness to the creditor that is non-negotiable, nothing more.

The fallacy that lurks in this argument consists in transferring to the interpretation of the term "borrow money" a strictness of construction that does not belong there,—that belongs only to a determination of the objects for which money may be borrowed. The expression, "for general purposes," may properly enough be

[1] Hill *v.* Memphis, 134 U. S. 203.

restricted within such limits as the courts shall deem to be required for the protection of the taxpayer; but there is really no good reason for disturbing settled rules of construction, and depriving the term "to borrow money" of its ordinary and usual meaning.

If the court seeks to discover what the Legislature of Texas, in 1873, meant when it conferred the chartered power upon the city of Brenham to borrow money for general purposes,[1] there would seem to be two obvious replies to such inquiry.

First. It meant to give the right to borrow money by the usual and customary methods that were prevailing among municipal corporations at that period in the State of Texas.

Second. By providing, in the very Act creating the charter, that the bonds of the city of Brenham should not be subject to tax, the Legislature clearly indicated a purpose to clothe the city with authority to issue a negotiable bond, should it at a future day become necessary so to do in the exercise of its power to borrow money.

The pernicious results that are sure to attend this abrogation by a majority of the justices of the Supreme Court of a long-established rule of property, it is not easy to estimate. It falls with severity upon many prudent holders, who had a right to regard the settled construction as incapable of reversal. But this is by no means all. It will serve to beget a desire for repudiation in communities otherwise disposed promptly to pay their honest debts. It will give a pretence to unscrupulous leaders to foment discontent at the administration of municipal finances, and thus tend to precipitate disturbances that will inevitably injure to a serious degree the credit of their respective localities. It creates distrust, and imparts a shock to a class of securities in which a large number of persons of moderate means are vitally interested. Finally, with no corresponding advantage gained, it stigmatizes the Supreme Court of thirty years ago, and of succeeding years, as having been mistaken upon a plain point of law, and does so for reasons which to the minds of many of the Bar are wholly inadequate and radically unsound.

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[1] What did the phrase "to borrow money" mean in 1873, when Brenham took her charter? That is the sole inquiry. Did the Legislature and the city unite in a mutual understanding of its meaning? What the justices to-day may think such a term ought to mean, as a question *de novo*, is interesting; but in 1873 there was no divergence of opinion upon this point. It simply meant power to obtain money in the method then everywhere resorted to by municipal corporations having occasion to borrow.

The foregoing observations, we may say by way of postscript, had assumed their present form with no opportunity on our part to learn what were the views of the dissenting members of the court. Now that the opinion of Mr. Justice Harlan — concurred in by Messrs. Justices Brewer and Brown — is printed, we feel compelled, for lack of space, to content ourselves with only the briefest reference to what is there ably and convincingly put.

Mr. Justice Harlan controverts the statement of the majority of the court that Rogers *v.* Burlington has been overruled by later adjudications: —

"We cannot give our assent to the doctrine announced in the present case, nor — we submit with some confidence — is that doctrine sustained by any decision of this court which has been cited."

The opinion then takes up the decisions cited by Mr. Justice Blatchford, and points out that in no one of them was a question raised as to negotiable securities being issued under an express power to borrow money.

Inasmuch as Mr. Justice Harlan united with his brethren in deciding Merrill *v.* Monticello, it is interesting to note how he disposes of the conclusions of the court in that case. We quote as follows: —

"The case which seems to be much relied on to support the present judgment is Merrill *v.* Monticello; but we submit that it does not sustain the broad doctrine that negotiable securities may not be issued in execution of an *express* power to *borrow money*. What could or could not be done under such a power was not a question involved in that case. The question was whether authority in the town of Monticello to issue negotiable bonds could be *implied*, not from an express but from an *implied* power to borrow money. After observing that, under the laws of Indiana, the proposition that a town has an *implied* authority to borrow money, or contract a loan, under the conditions and in the manner expressly prescribed, was not to be controverted, the court, speaking by Mr. Justice Lamar, said: 'But this only brings us back to the question, Does the *implied* power to *borrow* money or contract a loan carry with it a *further implication* of power to issue negotiable bonds for that amount, and sell them in open market?'

"The question in that case, as framed by the court, clearly shows that it was only considering whether an authority in a municipal corporation to issue negotiable securities could be *implied* from a power to borrow which was *itself* to be *implied* from other powers granted. This also appears from the following clause in the opinion: 'It is admitted that

the power to *borrow* money, or to incur indebtedness, *carries with it* the power to issue *the usual evidences of indebtedness*, by the corporation, to the lender or other creditor. Such evidences may be in the form of *promissory notes, warrants, and, perhaps, most generally, in that of a bond.*' And it is further shown by the fact that the opinion, referring to the clause in Police Jury *v.* Britton, above quoted, which states that authority in a municipal corporation to issue negotiable securities may be implied from an *express* power to *borrow* money, states that it has no application to the case then before the court, in which the attempt was made to *imply* authority to issue negotiable bonds simply from an *implied* power to *borrow money.*"

This explanation, we may be permitted to say, strikes us as not particularly happy. That decision, it is true, does not deal with the meaning of an express power to borrow money; but Mr. Justice Lamar's opinion, in unmistakable terms, assumes to point out and to dwell upon a distinction between a power to borrow money and a power to issue negotiable securities. As stated in our former article, we fail to perceive the difference, in the logical consequences involved, between an implied power, once legally established, and a power created in express terms, to borrow money.

Mr. Justice Harlan cites City of Savannah *v.* Kelly,[1] as very much in point; and quotes with approval from Judge Dillon as follows:

"*Express power to borrow money*, perhaps, in all cases, but especially if conferred to effect objects for which large or unusual sums are required, — as, for example, subscriptions to aid railways and other public improvements, — will ordinarily be taken, if there be nothing in the legislation to negative the inference, to include the power (the same as if conferred upon a corporation organized for pecuniary profit) to issue negotiable paper with all the incidents of negotiability." [2]

The provision in the Brenham charter that *bonds* shall not be subject to tax, is referred to as justifying the application of the rule laid down by Dillon. The opinion closes with the following emphatic protest: —

"It seems to us that the court, in the present case, announces for the first time that an express power in a municipal corporation to borrow money, for corporate or general purposes, does not, under any circumstances, carry with it, by implication, authority to execute a negotiable promissory note or bond for the money so borrowed, and that any such

[1] 108 U. S. 184.

[2] 1 Municipal Corporations, 4th ed., § 125.

note or bond is void in the hands of a *bona-fide* holder for value. There are, perhaps, few municipal corporations anywhere that have not, under some circumstances, and within prescribed limits as to amount, express authority to borrow money for legitimate corporate purposes. While this authority may be abused, it is often vital to the public interests that it be exercised. But if it may not be exercised by giving negotiable notes or bonds as evidence of the indebtedness so created, — which is the mode usually adopted in such cases, — the power to borrow, however urgent the necessity, will be of little practical value. Those who have money to lend will not lend it upon mere vouchers or certificates of indebtedness. The aggregate amount of negotiable notes and bonds, executed by municipal corporations for legitimate purposes, under express power to borrow money simply, and now outstanding in every part of the country, must be enormous. A declaration by this court that such notes and bonds are void, because of the absence of *express* legislative authority to execute *negotiable* instruments for the money borrowed, will, we fear, produce incalculable mischief. Believing the doctrine announced by the court to be unsound upon principle and authority, we do not feel at liberty to withhold an expression of our dissent from the opinion."

It may fairly be assumed that the profession will not be disposed to suffer a doctrine of this wide application, upheld as it is by five justices in the face of a dissent so vigorous, to pass unchallenged. When a vacancy in the court shall no longer exist, it will be well if the question can be brought before a full bench of nine justices, in a form fitted for a most careful review of the whole subject. Whatever may be the conclusion then reached it is to be hoped that it will be supported by a process of reasoning that can leave no room to question its logical soundness.

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